(5)

No. 89-1452

IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONERS

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TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

REPLY BRIEF FOR PETITIONERS

Respondents' brief in opposition to certiorari is striking primarily for what it does not dispute. Respondents do not deny that this case is of immense practical importance to the entire natural gas industry, despite (indeed, because of) the enactment of the Wellhead Decontrol Act.[1] They do not deny that the court of appeals expressly held that the Federal Energy Regulatory Commission ("FERC") lacks authority under Sections 104 and 106 of the Natural Gas Policy Act ("NGPA") to set a single maximum price for all vintages of old gas. Nor do they deny that this holding, as well as the court's interpretation of Section 7(b) of the Natural Gas Act ("NGA"), fails to accord any deference to the FERC's interpretations of those provisions, contrary to this Court's decisions in *Chevron U.S.A.* v. *NRDC*, 467 U.S. 837 (1984), and *K Mart Corp.* v. *Cartier*, 486 U.S. 281 (1988). Indeed, they do not even mention the latter decision. Nor do they deny that the court of appeals' resolution of the take-or-pay question is contrary to the D.C. Circuit's decisions in *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), and *Neighborhood TV Co.* v. *FCC*, 742 F.2d 629 (D.C. Cir. 1984). Instead, respondents primarily argue that they should prevail on the merits, and that the unsubstantiated policy arguments on which they relied in opposing this Court's issuance of a stay also militate against a grant of certiorari.

1. Respondents' only response to the widespread, immediate impact of vacating Order 451, as explained by

[1] Indeed, virtually everyone connected with the natural gas industry—producers, pipelines, customers (some of whom support the petitioners and others the respondents), as well as the FERC, the industry's principal regulator—is now before this Court. Moreover, the Department of Energy and the Justice Department were actively involved in the proceedings before the FERC. The widespread interest in this case attests to the practical importance of the decision below.

both the private and government petitioners (Pet. 2-3, 13, 17-18, 26-29; U.S. Pet. 26-27), is to quibble over the numbers petitioners use to document the magnitude of the problem. See Opp. 17.[2] Respondents do not (and could not) dispute that the court of appeals' decision casts into doubt thousands of gas supply contracts covering billions of dollars worth of reserves (Pet. 26-27, 28-29 n.18), and that it creates a risk that approximately 1.6 *trillion* cubic feet of gas contracted to new customers under Order 451 will have to be redirected to the original customers (*id.* at 27). By themselves, these effects make this case enormously important.[3]

With respect to the future importance of the court of appeals' decision, respondents do not dispute (or even address) petitioners' demonstration that the pricing policies embodied in Order 451 were essential to Congress's decision to enact the Wellhead Decontrol Act, and that the court of appeals' decision would thwart the orderly transition to decontrol mandated by that Act. Pet. 28. Nor do they dispute that substantial quantities of gas for which wellhead price regulation will be eliminated on January 1, 1993 (when full decontrol takes effect) will, in the interim, continue to be subject to Order 451 and therefore eligible for renegotiation under the Order's Good Faith Negotiation ("GFN") procedures. See *id.* at 28-29 n.18. Nor do they dispute that Order 451 will continue to have an enormous impact beyond 1993 because many of the contracts it affects extend well beyond

[2] Petitioners' estimates of the number of contracts potentially affected by the decision of the court of appeals differs from the FERC's estimate because the former was based upon a survey of petitioners' own operations, while the latter was based upon an older DOE study. Compare Pet. 26-27 with U.S. Pet. 26.

[3] Respondents' unsupported assertion that the private negotiation procedure established by the Wellhead Decontrol Act will ameliorate these difficulties (Opp. 18) is wrong. Parties would be free to settle disputes arising from the invalidation of Order 451 without those procedures. The problem is that many unsettled disputes will be litigated in the courts or before the FERC, creating substantial costs and years of uncertainty for both consumers and producers.

that date. *Id.* Thus, respondents' unsupported claim that the Wellhead Decontrol Act deprives the decision below of "any long-term significance" (Opp. 16) is plainly wrong.

Respondents' practical arguments in favor of the decision below are belied by their own submission. In a footnote (Opp. 9 n.5), respondents concede that during the nearly four years since Order 451 took effect, and even before adjusting for inflation, the average spot market price for natural gas has *declined* approximately 20 to 45 percent. Later, respondents argue (Opp. 13) that Order 451's GFN procedure has caused increased prices for old gas and therefore should be struck down. But they ignore the other side of the equation, which was that this procedure was also designed to decrease the price of new gas by facilitating the restructuring of hundreds of inflexible, non-market responsive contracts. See Pet. 11 (citing 51 Fed. Reg. at 22,204-206). By highlighting the decline in overall prices that has occurred since Order 451 took effect, respondents footnote demonstrates that the FERC properly balanced the negotiation process, contrary to claims that the GFN process is "one-sided."[4] In any event, all of respondents' policy arguments beg the fundamental question of who should make such policy choices—the federal agency charged by Congress with regulating the natural glas industry, or two federal appeals court judges. See Pet. 5-6, 18-21.[5]

[4] Moreover, contrary to respondents' repeated suggestion (Opp. 9, 13, 17), that gas subject to Order 451 is typically sold at above-market prices, a recent Department of Energy study concludes that "almost all" of the contracts renegotiated under Order 451 limit the price to the *lower* of the market price or the regulatory ceiling price. *Natural Gas Price Controls: Hearing on H.R. 1595 Before the Subcomm. on Energy and Power of the House Committee on Energy and Commerce*, 101st Cong., 1st Sess. 156 (Apr. 5, 1989).

[5] Respondents also attempt to defend, on various equitable grounds, the distribution of the "burdens" (Opp. 19) imposed by the admitted "practical problems" (Opp. 18) created by the

2. Contrary to the misleading impression respondents attempt to create (Opp. at 21-22), the court of appeals squarely held that the FERC lacks authority under Sections 104(b)(2) and 106(c) to "abrogat[e] the vintage pricing structure" (Pet. App. 25a) by setting a single ceiling price for all vintages of old gas. After summarizing the FERC's discussion of its own authority under those provisions, the court held as follows:

> Congress' intent was, as it has been in the past, to protect the interests of the consumer through the incorporation of a vintaged old gas pricing scheme *'as a significant feature of the NGPA's design.'* . . . For the Commission to jettison a 'significant feature of the NGPA's design' by abrogating the vintage pricing structure, represents, in our view, an improper exercise by the Commission of its limited authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c). *Id.* at 24a-25a (emphasis in original).

For this reason, the court vacated the FERC's orders, concluding that the FERC "has exceeded the scope of its authority under the NGPA." *Id.* at 25a, 36a.

Respondents do not defend this holding against the errors demonstrated in the petitions for certiorari. They do not deny that it is contrary to the plain language of the NGPA. See Pet. 18-20; U.S. Pet. 22-23. Indeed, they rely heavily upon a decision of this Court that *upheld* the FERC's interpretation of another NGPA provision based solely upon its "plain language." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Respondents, however, studiously avoid quoting or discussing the language of the provisions at issue in this case, preferring instead to rely upon "what Congress

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court of appeals' decision. See Opp. 17-19. Such arguments might be relevant if respondents were still opposing petitioners' stay application. See, *e.g.*, *NCAA* v. *Board of Regents*, 463 U.S. 1311, 1314 (1983) (White, J., in chambers) (discussing "stay equities"). But they have no bearing whatever on whether this Court, having granted a stay, should now grant the petitions for certiorari.

had in mind." See Opp. 25. Respondents also do not deny that the court of appeals improperly relied upon legislative history to overturn a FERC interpretation that plainly does not contravene the statutory language (see Pet. 17, 20 (citing *K Mart*, *supra*); U.S. Pet. 22-23) and cannot fairly be said to be unreasonable (see Pet. 20-21 (citing *Chevron*, *supra*); U.S. Pet. 22-23).

Instead, respondents repeatedly argue that because the *particular* maximum lawful price the FERC chose exceeded the then-existing spot market price, that price necessarily fails the "just and reasonable" requirement because it amounts to "deregulation" of old gas prices. See Opp. 4, 14-15, 21-22. This, according to respondents, was "the real basis" (*id.* at 22) of the court's decision. That is wrong. The question whether FERC has authority to set a single maximum price for all old gas is distinct from the question whether that price is "just and reasonable." Although there are references in its opinion to the "just and reasonable" question, the court of appeals, as shown above (*supra* 4), clearly reached a holding on the question of the FERC's authority to set a single maximum price for all old gas. That question, which is also the principal question presented in the Government's petition, is squarely before this Court.

But even if respondents have correctly interpreted the decision below—*i.e.*, as holding that the maximum price FERC chose for all old gas is unjust and unreasonable because it is above the spot market price that existed in 1986—that is yet another powerful reason for granting certiorari. A judicial decision that a ceiling price fails the "just and reasonable" requirement whenever it is above the then-prevailing spot market price would be an extraordinary constraint, not only on the FERC's ratemaking powers, but also on the ratemaking powers of numerous agencies that regulate rates pursuant to a "just and reasonable" standard. It would be flatly contrary to this Court's repeated calls for judicial deference to a regulatory commission's application of that stand-

ard. See, *e.g.*, *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981) ("No court may substitute its own judgment on reasonableness for the judgment of the Commission."); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 307 (1974) ("[C]ourts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'") (citations omitted).[6] And it would violate the same principles of statutory construction, embodied in such decisions as *Chevron* and *K Mart*, that the court of appeals violated in holding that the FERC lacks authority to set a single ceiling price for all vintages of old gas. See Pet. 18-21; U.S. Pet. 16-17.[7]

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[6] Such a holding also would be impossible to reconcile with this Court's *Mobile-Sierra* doctrine, which recognizes that market rates will sometimes be below the maximum rates established by the regulatory process. See *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956); *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332, 343 (1956). Inasmuch as a price negotiated by two parties in an arms-length transaction is the definition of a market price, the NGA's "recogni[tion] that rates to particular customers may be set by individual contracts" (350 U.S. at 338) necessarily assumes that the ceiling price established under the "just and reasonable" standard of the NGA will sometimes be above the market rate. See *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 372 (5th Cir.), *cert. denied*, 454 U.S. 1142 (1982). This element of the *Mobile-Sierra* doctrine, moreover, has been incorporated in Section 101(b)(9) of the NGPA. *Id.*

Nor is there any basis for respondents' assertion that rate regulation is designed solely to protect consumers by keeping rates below market levels. In order to ensure adequate supplies, rate regulation necessarily must consider investor interests as well as consumers' short-run interest in low prices. See, *e.g.*, *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Thus, respondents' naked assertions that consumer interests must be paramount merely raises the issue of how prices can best be structured to serve consumers' interests over the long run. Respondents' footnote 5 proves how effective Order 451 has been in that respect. *See supra* 3.

[7] Moreover, even if this Court agreed with respondents on the merits and held that the ceiling price adopted by the FERC was unjust and unreasonable, that would in no way reduce the need to resolve the fundamental issue regarding the scope of FERC's authority under Sections 104(b)(2) and 106(c). By itself, such a holding would not affect FERC's authority to set a single ceiling price for all old gas. It would therefore leave intact FERC's underlying authority to promulgate a regulation similar to Order 451, albeit with a different ceiling price.

Thus, respondents' revisionist interpretation of the court of appeals' opinion does nothing to diminish the necessity for further review by this Court.

As to the merits of respondents' argument, it is simply incorrect to label the Commission's action as "deregulation." The fact that a fluctuating spot market price may be below ceiling prices at a particular point in time does not mean that the gas is no longer subject to price controls. See Pet. 10-11, 19 n.11. Respondents themselves recognize that, at various times prior to Order 451, "the market price dropped substantially below the NGPA ceilings" (Opp. 23), yet this did not mean the gas was thereby "deregulated." The "deregulation" label also adds nothing to the analysis: As an original matter, the lawfulness of FERC's action with respect to the pricing of old gas depends upon (1) whether the Commission has authority under Sections 104(b)(2) and 106(c) of the NGPA to adopt a single ceiling price for all vintages of old gas, and (2) whether that ceiling price is just and reasonable within the meaning of the NGA. Respondents' "deregulation" argument not only fails to answer those questions, but also ignores the statutory language and this Court's decisions in *Chevron* and *K Mart*. See Pet. 10 & n.7, 14.

3. Similarly, nothing in respondents' brief casts any doubt on the need to review the court of appeals' holding on the issue of FERC's abandonment authority under Section 7(b) of the Natural Gas Act. Respondents do not and cannot deny the breadth of the court of appeals' holding, *i.e.*, that the Commission lacks authority to enact a generic, "across the board, pre-authorized abandonment provision" under Section 7(b). Pet. App. 29a. Indeed, respondents describe the court of appeals' decision as a holding that abandonment may not be granted under Sec-

tion 7(b) "without . . . any examination of the facts and circumstances of a particular proposal." Opp. 27. Thus, respondents implicitly concede that the holding raises a serious conflict in principle with *Chevron*, *K Mart* and similar decisions in the other courts of appeals, all of which counsel deference to the FERC's judgment on matters of stautory interpretation. See Pet. 22. By itself, that conflict warrants this Court's attention.

Respondents do attempt to distinguish *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479 (D.C. Cir. 1988). Contrary to respondents' assertion, however, both of those decisions plainly permitted abandonment of service under Section 7(b) *without* any "examination of the facts and circumstances" of each proposal. In *Associated Gas Distributors*, the D.C. Circuit specifically upheld as consistent with Section 7(b) a regulation in which, as in this case, "the Commission . . . identified circumstances under which pipelines are automatically entitled to abandonment of service . . ." 824 F.2d at 1015; see also *id.* at 1015-1016 & n.17. Since it was "automatic," the regulation provided no opportunity for examination of the facts of each case prior to abandonment.[8] The same was true in *Kansas Power & Light*. See 851 F.2d at 1483. Moreover, although in the latter case the D.C. Circuit did note that the complaining party would have an opportunity to challenge the abandonment collaterally—in a *later* prudence review proceeding—it plainly did not rely upon that opportunity to satisfy the "due hearing" requirement of Section 7(b). See 851 F.2d at 1484. The conflict between the decision of the Fifth Circuit in this

[8] Respondents also attempt to distinguish *Associated Gas Distributors* on the further ground that in that case the purchaser elected to reduce its purchases. Opp. 27. But this fact is irrelevant under the court of appeals' broad holding in this case that Section 7(b) does not permit "an across the board, pre-authorized abandonment provision" (Pet. App. 29a), *i.e.*, that Section 7(b) requires an "examination of the facts and circumstances of a particular proposal" (Opp. 27) before abandonment can be authorized.

case and the decisions of the D.C. Circuit in *Associated Gas Distributors* and *Kansas Power & Light* could not be more clear.[9]

Respondents' attempt (Opp. 25-26) to buttress the decision below with dicta from this Court's decision in *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), does nothing to diminish the importance of the abandonment issue in this case. It is wholly unpersuasive. As petitioners have already explained (Pet. 22 n.13), the problem with the abandonment at issue in *McCombs* was that the Commission had given no approval for it, pregranted or otherwise. See 442 U.S. at 533-34. The Court's reference to "a hypothetical set of facts," moreover, was simply part of a discussion, acknowledged by the Court as dicta (see *id.* at 540), of the potential problems that would arise from *retroactive* abandonment authorization. In short, the decision below finds no support in either the holding or the reasoning of *McCombs*.

4. Finally, respondents' assertion that the court of appeals' resolution of the take-or-pay issue does "not present any question suitable for review" (Opp. 28) is without merit. The majority below plainly believed it was resolving a question "suitable for review," as evidenced by the six paragraphs of its opinion, under a separate heading, that it devoted to that issue. See Pet. App. 30a-33a. Judge Brown, moreover, criticized the majority for "presuming to *direct* the Commission to consider, and once and for all to *solve*" (Pet. App. 55a (first emphasis

[9] The FERC properly concluded (51 Fed. Reg. at 22,205) that the notice and comment rulemaking procedures it followed in promulgating Order 451 satisfy the "due hearing" requirement of Section 7(b). The Tenth Circuit has squarely held that an administrative rulemaking satisfies the "hearing" requirement imposed by Section 5 of the NGA, which is indistinguishable from that imposed by Section 7(b). *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-52 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974). Thus, to the extent the decision below holds that a rulemaking does not satisfy the hearing requirement of Section 7(b), it conflicts with *Phillips Petroleum*.

added)) the take-or-pay problem, and the majority did not deny that charge. The FERC itself, moreover, plainly shares Judge Brown's interpretation of the majority's decision. See U.S. Pet. 25-26. Thus, this part of the opinion cannot simply be ignored, as respondents suggest.

Moreover, respondents do not deny that, if it is a holding, the majority's resolution of the take-or-pay issue squarely conflicts with the D.C. Circuit's decisions in *Wisconsin Gas*, *supra*, and *Neighborhood TV*, *supra*. See Pet. 23-26. Indeed, respondents do not even cite or discuss those decisions. The court of appeals' resolution of the take-or-pay issue thus presents a circuit conflict that warrants resolution by this Court, along with the other two issues presented in the petitions.

CONCLUSION

For the foregoing reasons, and for those stated in the petitions for certiorari, a writ of certiorari should be granted.

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